

TAX MATTERS

A newsletter dedicated to informing California Aircraft and Vessel owners about taxes

Prepared and distributed by Aero & Marine Tax Professionals

Legally Avoiding Sales and Use Tax on Aircraft Purchases...A Challenge Best Left to Professionals.

By Thomas Alston

Anyone who buys or flies an aircraft in California is subject to taxation, but specialists can help purchasers save thousands of dollars.

Imagine getting slapped with a \$100,000 past-due tax bill from the State of California several years after you purchased an aircraft, and you don't even live in that state. Think it can't happen? Better think again, as this type of scenario plays out with increasing frequency as the State of California grapples with perennial budget shortages.

As a money professional, your clients look to you for protection from such catastrophic events. At first glance, seeking an exemption seems simple enough. For several reasons, though, ensuring that your client is completely absolved of any sales or use tax involves several complicated steps, tremendous documentation, and often several trips to the state capital in Sacramento. One mis-step can completely undermine your efforts, leaving your client with a stiff tax levy.

Given the expensive consequences of failure, many attorneys, CPAs, and other business professionals are now turning to specialists that focus solely on defending aircraft purchasers against the California State Board of Equalization (BOE). These individuals and their staffs possess the knowledge and expertise to ensure that your client meets the exemption requirements and is legally absolved of paying sales or use tax. The best of them guarantee their results, resulting in satisfied clients who save money.

An Issue of National Importance

Of the 360,000 general aviation aircraft currently registered in the United States, 11% are based in California. Additionally, approximately 10% (250-400) of all new and used aircraft sales occur in California each month. These numbers alone justify further understanding of California's tax laws.

California regulations dictate that aircraft purchased out-of-state, but brought into California within 90 days, will be presumed to have been purchased for use in the state. In other words, a "use" tax could be levied on anyone, in any state, if they land in California.

The use tax is set at the same rate as the sales tax as much as 8.5% with a new ? % increase in the works. The obligation to pay use tax is on the purchaser and the return is due within twelve months from the date of the transaction. However, by following the exact letter of the law, or employing someone to do so, an exemption to taxation can be obtained, saving the purchaser tens of thousands of dollars or more.

A Problem That Will Not Go Away

The most insidious aspect of this tax is that the BOE has as much as nine years after an aircraft purchase transaction to legally notify you that you have been assessed. Just because a tax notice hasn't been sent, doesn't mean that that the obligation has been forestalled.

Until the BOE issues a document that affirms support of your exemption, you remain liable. Ignoring the process invites economic disaster as the state maintains the right to assess penalties and interest, which has been known to increase the amount originally owed by 50% or more. Escape is futile, as the BOE uncovers tax dodgers by combing through property tax assessments, performing routine audits of California retailers who sell aviation fuel or maintenance work, and through random inspections at airports where the local property tax assessors run a check on the tail number of every plane on the tarmac.

In one documented case an original \$80,000 sales tax bill incurred \$8,000 in penalties and \$65,000 in interest because the out-of-state owner of the aircraft ignored the notice of tax assessment for eight years. The state finally issued a Notice of Determination--at which point, the only way a taxpayer can obtain a hearing to

prove exemption is to pay the entire tax and file a claim for refund. However, the aircraft owner could not recover the documentation to support the rightful exemption and had to forfeit the entire amount.

The teeth for this ultimate enforcement stems from the BOE's ability to place a lien on the aircraft and even on accounts held in California-chartered banks as well as national banks, thrifts, and brokerage houses operating within the state.

The Challenge of Avoiding Sales and Use Tax Without the Right Help

Understandably, any individual or corporation operating a plane that expects to touch down in California will likely turn to their financial advisor, accountant, or attorney for help. Yet the process of legally avoiding sales tax can prove quite daunting, even if it is only the time-consuming "detail" work that deters most professionals.

"We're lawyers and we understand what the law is and can advise our clients accordingly, but it's not very efficient to hire people like us to do the detailed work, the day-to-day accumulation of data, the preparation of materials that need to be distributed to the state board," affirms Kevin Austin, the principal, at Aero Law Group, PLLC of Bellevue, Washington--an aviation practice that includes the representation of commercial airlines, emerging aviation companies, and businesses, institutions and individuals involved in the sale, lease, exchange and financing of commercial and business aircraft. "We charge such a high hourly rate for our legal services that the idea of somebody coming to us to carry out the day to day tasks to qualify for an exemption from sales and use tax is not very cost effective. We've done it before, but it can cost up to \$20-30,000."

"Some lawyers like to do that work themselves because it's a great source of revenue," continues Austin. "However, a lot of it is not typically lawyer-type work: looking through log books, keeping track of various flight requirements, where the airplane's gone, where' the airplane's been, and who was on it. It doesn't take a legal background to do that kind of work."

Clients Save Money by Turning to Specialists

Firms such as Aero Marine Tax Professionals routinely obtain referrals from attorneys and accountants for the specific purpose of walking a client through the maze of obtaining an exemption from sales and use taxes.

"Before companies like us came along, most money professionals only had the time to print copies of the regulations, send them to their client with some instructions, and then wish them good luck," acknowledges Alston. "Rightfully so, their time is too valuable to do any follow up. On the other hand, specializing in avoiding sales tax on aircraft and vessels is all we do."

"Part of our success stems from researching years of decisions and recommendations by the BOE," explains Alston. "These are like a legal brief of every case that went before one of the hearing officers. What you get is the board's entire case laid out with evidence, and their decision, along with the 'why' of it. We just made a checklist of all the failure points, and we apply 100% of the points to every one of our customers. As a result, there isn't any way for them to fail to win their exemption."

As an example, Alston explained how, in some cases, the BOE requires that a purchaser leave a plane outside of the state for more than 90 days before it enters the first time. But Alston raised the bar to 120 days on that test for strategic reasons. It strengthens the owner's case because merely accepting delivery in another state and parking it in a hanger for a few months seldom insures a situation where the transaction will be held as non-taxable.

Alston's company also immerses itself in the follow-up process, constantly maintaining two-way communication with the client to ensure compliance on all counts.

"We gather information on an interactive basis and perform all of the documentation in real time," explains Alston. "In this manner, we make sure the client is complying with all the steps, and it also avoids any misunderstandings. We prepare a tax return, run it through a couple sets of internal reviews, and the submission to the BOE."

The same methodical practices are also required when obtaining exemptions for common carrier clients who run charter operations, an especially important service since most air carrier executives and flight department managers initially rely upon the false belief that "Part 135" will obviate the need to deal with the California BOE.

According to Alston, while Part 135 is referenced in federal regulations, it is not mentioned in the California code. Instead, California Regulations 6366 and 6366.1 pertain to aircraft sold or leased to common carriers. These sections do offer legal exemptions.

However, the law requires the longest test period (12 months), during which time extremely detailed documentation must be maintained: log books, flight plans, weight and balance sheets, customer revenue billings, a complete copy of engine maintenance logs showing total hours since date of purchase, and more. Every single flight is examined and one mistake can trigger the entire tax. It takes precise guidance from an expert to guarantee compliance.

Of all the services that specialists such as Aero & Marine Tax Professionals provide, the most appreciated by clients, and those that refer them, is the fact that these specialists insert themselves between the client and the BOE staff.

"They don't ever have to talk to the auditors," assures Alston. "Once we get a letter of authorization, then the Board has to talk to us. When you understand how the word 'tax audit' affects the spine of most human beings, this helps a lot."

The whole process culminates with receipt by the client, of a letter from the BOE stating that the exemption has been supported--a common result for the group at Aero & Marine Tax Professionals.

"What makes us unique is that we guarantee the service," says Alston. "As long as the client engages us before possession of the aircraft and then explicitly follows our instructions, they get a written guarantee that they will legally avoid California sales and use tax, or our entire service is gratis. We've never had to pay anyone back, though, because we've won every case."

Summary

A recent report written by the Board of Equalization estimates that in a one year period, over \$54 million in tax was being lost through the granting of exemptions. Considering the services of a sales tax specialist can enable clients to become one of the fortunate individuals to keep a portion of this money in their bank accounts.

"Tom has successfully assisted some of my clients in their sales and use tax planning," says Aero Law's Kevin Austin. "I would definitely recommend him to others."